



**Gardner | Provenzano
Schauman & Thomas**

CERTIFIED PUBLIC ACCOUNTANTS

Frederick C. Gardner
Giacamo Provenzano
James R. Schauman
Heather A. Thomas

ARENAC EASTERN SCHOOL DISTRICT

Twining, Michigan

Financial Statements

June 30, 2006

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ARENAC EASTERN SCHOOL DISTRICT
TWINING, MICHIGAN
JUNE 30, 2006

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INDEPENDENT AUDITOR'S REPORT

August 23, 2006

To the Board of Education
Arenac Eastern School District
Twining, Michigan

We have audited the accompanying financial statements of the governmental activities of Arenac Eastern School District, as of and for the year ended June 30, 2006, which comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Arenac Eastern School District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities of the Arenac Eastern School District as of June 30, 2006, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

To the Board of Education
Arenac Eastern School District
Page Two

In accordance with *Government Auditing Standards*, we have also issued our report dated August 23, 2006, on our consideration of Arenac Eastern School District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Gardner, Provenzano, Schaumman & Thomas, P.C.

Certified Public Accountants

**ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

This section of the annual financial report presents management's discussion and analysis of Arenac Eastern School District's performance during the fiscal year ending June 30, 2006. Please read this along with the financial statements that follow for a comprehensive understanding of the financial position of the School District.

Annual Report

The annual report consists of our Management's Discussion and Analysis, a series of financial statements, notes to those statements, and supplemental information. The financial statements are divided into two sections. The District-Wide Financial Statements (Government-Wide Financial Statements) provide information about the activities of the School District as a whole. They present a year-end aggregate view and a longer-term view of the District's finances. All funds and capital assets are combined. The Fund Financial Statements (Governmental Fund Statements) provide more detail showing the year's activity by fund. They also show the amount available to finance future programs. Fund Statements do not include long-term items such as capital assets or long-term debt.

District-Wide Financial Statements

The District-Wide Financial Statements appear first in the financial statements. They present information on the School District as a whole. They show net assets and a statement of activities for the year. These statements include all assets and liabilities using the accrual basis of accounting, similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

Net assets, the difference between assets and liabilities, are one way of measuring the financial health of the School District. In the statement of activities, the revenues less the expenses result in an increase or decrease in the net assets. Increases or decreases in net assets, over time, affect the financial health of the District. However, the goal of the School District is to provide quality education and a safe environment, not to make a profit.

The statement of activities covers all of the School District's services, including instruction, supporting services, community services, athletics, and food services. Property taxes, unrestricted State Aid, and State and Federal grants finance most of these activities.

ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Fund Financial Statements

The Fund Financial Statements provide detailed information on a fund level instead of the School District as a whole. Some funds are required to be established by State law and by bond covenants. Many of the other funds are created to help control and manage money for a particular purpose or to meet legal responsibilities for certain taxes, grants, and other money. The governmental funds of the School District focus on showing how money flows into and out of funds and the balances left at year-end. They provide a detailed, short-term view of the operations and services of the School District. This helps determine whether more or fewer financial resources are available for future programs. An accounting method called modified accrual accounting is used in fund accounting. This method measures cash and all other financial assets that can readily be converted to cash.

The relationship between governmental activities (District-Wide Financial Statements) and governmental fund activities (Fund Financial Statements) will be reconciled later in the annual report.

Agency and Trust Accounts

The School District acts as an agent for various student activity funds. These net assets are reported in separate statements. We exclude these net assets from the School District's other financial statement because we cannot use these assets to finance our operations. The School District is responsible for ensuring that the assets reported in these funds are used for their intended purpose.

ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Summary of District-Wide Financial Statement-Analysis of Overall Financial Position and Results of Operations

Table 1 provides a summary of our net assets as of June 30, 2006 and 2005. They represent the School District as a whole.

Assets	2006	2005
Current and other assets	\$ 978,521	\$ 1,297,868
Capital assets -		
Net of accumulated depreciation	3,341,508	3,399,295
Total assets	4,320,029	4,697,163
Liabilities		
Current liabilities	502,086	571,960
Long-term liabilities	2,646,579	2,762,422
Total liabilities	3,148,665	3,334,382
Net assets		
Invested in capital assets -		
net of related debt	713,162	599,035
Restricted for debt service	71,266	94,814
Restricted for capital projects	40,307	153,188
Unrestricted & undesignated	346,629	515,744
Total Net Assets	\$ 1,171,364	\$ 1,362,781

The School District's net assets were \$1,171,364 as of June 30, 2006. Capital assets, net of related debt, totaled \$713,162. This represents the original cost, less depreciation of the School District's capital assets, less long-term debt, related to capital assets. Restricted net assets of \$111,573 are reported separately to show legal constraints from debt covenants and enabling legislation that limit the School District's ability to use those net assets for day-to-day operations. The remaining amount of net assets was unrestricted. The \$346,629 in unrestricted net assets of government activities represents the accumulated results of all past years' operations. The unrestricted net asset balance is used for working capital and cash flow needs as well as to provide for future uncertainties. The operating results of the General Fund will have a significant impact on the change in unrestricted net assets from year to year.

The results of this year's operation for the School District as a whole are reported in the Statement of Activities, which shows the changes in net assets for fiscal years 2006 and 2005.

ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Summary of District-Wide Financial Statement-Analysis of Overall Financial Position and Results of Operations (continued)

Revenue	2006	2005
Program revenue		
Charges for services	\$ 66,871	\$ 67,874
Grants and contributions	642,391	635,106
General revenue		
Property taxes	485,739	468,717
State foundation allowance	2,330,619	2,380,473
Other	63,044	42,823
Total revenue	<u>3,588,664</u>	<u>3,594,993</u>
Function/Program expenses		
Instruction	2,223,812	2,262,503
Support services	1,091,091	1,129,961
Food services	144,734	153,029
Athletics	55,591	70,104
Interest & misc. expense on long-term debt	93,226	86,209
Depreciation (unallocated)	171,627	227,824
Total expenses	<u>3,780,081</u>	<u>3,929,630</u>
Increase (decrease) in Net Assets	<u>\$ (191,417)</u>	<u>\$ (334,637)</u>

As reported in the Statement of Activities, the cost of all of our governmental activities this year was \$3,780,081. Certain activities were partially funded through charges for services from those who benefited from the programs in the amount of \$66,871. Other governments and grantors subsidized certain programs with grants and contributions in the amount of \$642,391. We paid for the remaining "public benefit" portion of our governmental activities with \$485,739 in taxes, \$2,330,619 in State Foundation Allowance, and with our other revenues, such as interest and general entitlements.

The School District experienced a decrease in net assets of \$191,417. The assets decreased primarily as a result of ongoing operations in the School District. However, please note that net assets decreased by \$191,417 as opposed to \$334,637 in the prior year. This was a result of decreased depreciation expense, decreased athletics expense, and decreases in programs.

ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Summary of District-Wide Financial Statement-Analysis of Overall Financial Position and Results of Operations (continued)

As discussed above, the net cost shows the financial burden that was placed on the State and the Arenac Eastern School District's taxpayers by each of these functions. Since property taxes for operations and unrestricted State aid constitute the vast majority of School District operating revenue sources, the Board of Education and Administration must annually evaluate the needs of the School District and balance those needs with State-prescribed available unrestricted resources.

School District's Funds

As the School District completed this year, the general fund reported a fund balance of \$575,044, which is a decrease of \$81,830 from last year. The primary reason for this decrease is the use of fund balance to maintain programs. This decrease was not as large as the District had anticipated. Overall, actual general fund revenue and expenses were within 96% of budgeted amounts.

The special revenue fund balances include athletic and food service. The athletic fund has remained relatively stable. The food service fund reported a fund balance of \$16,322, which is a decrease of \$1,433 from last year. The decrease in the fund balance was the result of increased costs in food purchases, wages, and benefits, as well as, declining enrollment, resulting in fewer meals being served.

The debt service fund balance decreased to \$71,266, which is a decrease of \$19,325 from last year. Millage rates are determined annually to ensure that the School District accumulates sufficient funds to pay annual bond issue-related debt service. The fund balance in the debt service fund is reserved since it can only be used to pay debt service obligations.

The capital projects fund balance decreased by \$112,881 to \$40,307. The fund balance in the capital projects fund is reserved for future capital projects.

Budgetary Highlights

The Uniform Budget Act of the State of Michigan requires that the local Board of Education approve the original budget for the upcoming fiscal year prior to June 30, the end of the current fiscal year. Over the course of the year, the District revises its budget to reflect changes in revenues and expenditures. For fiscal year 2005-06 the budget was amended January 2006 and June 2006. A budgetary comparison schedule showing the school district's original budget and final amended budget amounts compared with actual amounts for revenue and expenditures is provided in required supplemental information of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Final Budget vs. Original Budget

The general fund original budget revenues were \$43,092 less than the final budget estimate of \$3,253,522. Changes to the general fund original revenue budget were the result of federal grant funds carried forward from the 2004-2005 school year.

The general fund original budget expenditures were \$23,617 more than the final budget estimate of \$3,400,873. Changes to the general fund original budget were the result of staffing changes made during the school year.

Actual vs. Final Budget

The general fund actual revenues were \$82,459 less than the final revenue budget estimate of \$3,253,522. This variance is due to Section 31A (At Risk) funds Michigan School Readiness (Preschool) funds and Title I & II funds carried over to the 2006-07 school year.

The general fund actual expenditures were \$147,980 less than the final expenditure budget projection of \$3,400,873. Section 31A (At Risk) funds, Michigan School Readiness (Preschool) funds, and Title I & II were not expended.

**ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

Capital Assets

As of June 30, 2006, the School District has \$3,341,508 in capital assets including land improvements, construction in progress, buildings, buses, vehicles, technology, furniture and equipment, less depreciation. This was a decrease of \$57,787 from the prior year.

The renovation project started at the end of school year 2003-04 has been completed. No other capital projects have been budgeted.

	2006	2005
Construction in progress	\$ -	\$ 1,552,368
Land Improvements	103,400	103,400
Buildings	4,627,375	2,961,167
Buses and other vehicles	305,196	434,203
Technology	404,039	404,039
Furniture and equipment	678,495	678,495
Total Capital Assets	6,118,505	6,133,672
Less accumulated depreciation	2,776,997	2,734,377
Net Capital Assets	\$ 3,341,508	\$ 3,399,295

Debt Activity

As of June 30, 2006, the School District had \$2,628,346 in General Obligation Bonds and Durant bonds outstanding versus \$2,800,260 in the previous year. Additional debt includes \$32,862 in compensated absences for vacation and sick pay leave and \$211,875 in retirement incentives.

	2006	2005
Governmental Activities		
Bonds	\$ 2,628,346	\$ 2,800,260
Accrued compensated absences	32,862	40,287
Retirement incentives	211,875	114,375
Totals	\$ 2,873,083	\$ 2,954,922

ARENAC EASTERN SCHOOL DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Economic Conditions Affecting Next Year's Budget

The District's student enrollment has been gradually declining approximately 10 students each year. A preliminary student count for 2006-07 indicates that the enrollment will decrease from the 2005-06 level by approximately 21 students. This will have a direct impact on the revenue the District will receive from the State.

The MPSERS retirement rate will increase to 17.74% on October 1, 2006 from the current rate of 16.34%.

Contacting the District's Financial Management

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the District's finances and to demonstrate the School District's accountability for the money it receives. If you have questions about this report or need additional information, please contact:

Rocky Aldrich
Superintendent
Arenac Eastern School District
200 Smalley Street
Twining, MI 48766
989 867-4234

BASIC FINANCIAL STATEMENTS

ARENAC EASTERN SCHOOL DISTRICT
DISTRICT WIDE STATEMENT OF NET ASSETS
JUNE 30, 2006

	Governmental Activities
Assets	
Cash	\$ 430,182
Inventories	656
Due from other governmental units	542,968
Other receivables	1,349
Prepays	3,366
Capital assets less accumulated depreciation	3,341,508
Total Assets	<u>4,320,029</u>
Liabilities	
Current liabilities	
Accounts payable	80,361
Accruals	133,672
Deferred revenue	61,549
Bonds payable, due within one year	182,004
Retirement incentives, due within one year	44,500
Long-term liabilities	
Bonds payable, due in more than one year	2,446,342
Retirement incentives, due in more than one year	167,375
Compensated absences, due in more than one year	32,862
Total Liabilities	<u>3,148,665</u>
Net Assets	
Invested in capital assets net of related debt	713,162
Restricted for debt service	71,266
Restricted for capital projects	40,307
Unrestricted & undesignated	346,629
Total Net Assets	<u>\$ 1,171,364</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
DISTRICT WIDE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2006

Functions/Programs	Expenses	Program Revenues		Governmental Activities
		Charges for Services	Operating Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets
Instruction	\$ 2,223,812	\$ 1,470	\$ 515,052	\$ (1,707,290)
Support services	1,091,091	-	23,675	(1,067,416)
Food services	144,734	39,164	103,564	(2,006)
Athletics	55,591	26,237	100	(29,254)
Interest & misc. expense on long-term debt	93,226	-	-	(93,226)
Depreciation (unallocated)	171,627	-	-	(171,627)
Totals	<u>\$ 3,780,081</u>	<u>\$ 66,871</u>	<u>\$ 642,391</u>	<u>(3,070,819)</u>
General revenues:				
Taxes:				
Property taxes levied for general purposes				241,998
Property taxes levied for debt service				243,741
State aid - unrestricted				2,330,619
Interest				12,030
Other				27,719
Subtotal General Revenues				<u>2,856,107</u>
Excess (deficiency) of revenue over expenses before special items				(214,712)
Special Items:				
Extraordinary item-insurance proceeds				22,095
Gain on sale of capital asset				<u>1,200</u>
Total general revenues, special items and extraordinary items extraordinary items				2,879,402
Change in Net Assets				(191,417)
Net Assets - Beginning of Year				1,362,781
Net Assets - End of Year				<u>\$ 1,171,364</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
GOVERNMENTAL FUNDS BALANCE SHEET
JUNE 30, 2006

	General	Food Service	Athletic	Debt Service	Capital Projects	Totals
<u>Assets</u>						
Cash	\$ 285,350	\$ 16,707	\$ 15,540	\$ 71,266	\$ 41,319	\$ 430,182
Inventory	-	656	-	-	-	656
Due from other funds	12,121	-	-	-	-	12,121
Due from other governmental units	541,500	1,468	-	-	-	542,968
Other receivable	1,349	-	-	-	-	1,349
Prepaid expenditures	3,366	-	-	-	-	3,366
Total Assets	<u>\$ 843,686</u>	<u>\$ 18,831</u>	<u>\$ 15,540</u>	<u>\$ 71,266</u>	<u>\$ 41,319</u>	<u>\$ 990,642</u>
<u>Liabilities and Fund Balance</u>						
<u>Liabilities</u>						
Accounts payable	\$ 75,326	\$ 302	\$ 3,721	\$ -	\$ 1,012	\$ 80,361
Due to other funds	-	302	11,819	-	-	12,121
Deferred revenue	61,549	-	-	-	-	61,549
Accrued expenditures	131,767	1,905	-	-	-	133,672
Total Liabilities	<u>268,642</u>	<u>2,509</u>	<u>15,540</u>	<u>-</u>	<u>1,012</u>	<u>287,703</u>
<u>Fund Balance</u>						
Reserved for debt retirement	-	-	-	71,266	-	71,266
Reserved for inventories	-	656	-	-	-	656
Undesignated	575,044	15,666	-	-	40,307	631,017
Total Fund Balance	<u>575,044</u>	<u>16,322</u>	<u>-</u>	<u>71,266</u>	<u>40,307</u>	<u>702,939</u>
Total Liabilities and Fund Balance	<u>\$ 843,686</u>	<u>\$ 18,831</u>	<u>\$ 15,540</u>	<u>\$ 71,266</u>	<u>\$ 41,319</u>	<u>\$ 990,642</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
 RECONCILIATION OF BALANCE SHEET OF GOVERNMENTAL FUNDS TO
 DISTRICT-WIDE STATEMENT OF NET ASSETS
 JUNE 30, 2006

Total Fund Balances - Governmental Funds	\$ 702,939
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and are not reported in the funds.	
The cost of the capital assets is	6,118,505
Accumulated depreciation is	(2,776,997)
Long-term liabilities are not due and payable in the current period and are not reported in the funds:	
Bonds payable	(2,628,346)
Compensated absences	(32,862)
Retirement incentives	(211,875)
Total Net Assets - Governmental Activities (District Wide)	<u>\$ 1,171,364</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2006

	General	Food Service	Athletic	Debt Service	Capital Projects	Totals
Revenue						
Local	\$ 278,425	\$ 39,737	\$26,337	\$ 244,228	\$ 959	\$ 589,686
State	2,615,186	6,537	-	2,777	-	2,624,500
Federal	221,109	97,027	-	-	-	318,136
Other	56,343	-	-	-	-	56,343
Total Revenue	<u>3,171,063</u>	<u>143,301</u>	<u>26,337</u>	<u>247,005</u>	<u>959</u>	<u>3,588,665</u>
Expenditures						
Instruction						
Basic programs	1,684,803	-	-	-	-	1,684,803
Added needs	448,934	-	-	-	-	448,934
Support services						
Pupil	81,985	-	-	-	-	81,985
Instructional staff	83,001	-	-	-	-	83,001
General administration	185,368	-	-	-	-	185,368
School administration	226,178	-	-	-	-	226,178
Business	55,546	-	-	-	-	55,546
Operation and maintenance	319,888	-	-	-	-	319,888
Pupil transportation services	124,661	-	-	-	-	124,661
Other	13,275	-	-	-	-	13,275
Capital Outlay	-	-	-	-	113,840	113,840
Debt Service	-	-	-	266,330	-	266,330
Food services	-	144,734	-	-	-	144,734
Athletic	-	-	55,591	-	-	55,591
Total Expenditures	<u>3,223,639</u>	<u>144,734</u>	<u>55,591</u>	<u>266,330</u>	<u>113,840</u>	<u>3,804,134</u>
Excess (Deficiency) of Revenues Over Expenditures	(52,576)	(1,433)	(29,254)	(19,325)	(112,881)	(215,469)
Other Financing Sources (Uses)						
Operating transfers in	-	-	29,254	-	-	29,254
Operating transfers out	(29,254)	-	-	-	-	(29,254)
Total Other Financing Sources (Uses)	<u>(29,254)</u>	<u>-</u>	<u>29,254</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net Change in Fund Balances	(81,830)	(1,433)	-	(19,325)	(112,881)	(215,469)
Fund Balances - Beginning of Year	656,874	17,755	-	90,591	153,188	918,408
Fund Balances - End of Year	<u>\$ 575,044</u>	<u>\$ 16,322</u>	<u>\$ -</u>	<u>\$ 71,266</u>	<u>\$ 40,307</u>	<u>\$ 702,939</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE
DISTRICT-WIDE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2006

Net Change in Fund Balances - Governmental Funds \$ (215,469)

Amounts reported for governmental activities in the statement
of activities are different because:

Governmental funds report capital outlay as expenditures;
in the statement of activities, these costs are capitalized
and depreciated over their estimated useful lives.

Depreciation expense	(171,627)
Capital outlay	113,840

The issuance of long-term debt (e.g. bonds) provides current financial
resources to governmental funds, while the repayment of the principal
of long-term debt consumes the current financial resources of
governmental funds. Neither transaction has any effect on net assets.

Repayment of bond principal	171,914
Retirement incentives	(120,000)

In the statement of activities, certain expenses (retirement
incentives, compensated absences) are measured by the
amounts earned during the year. The governmental funds
measure the financial resources used (paid). This year,
the amount of these items paid exceeded the amounts earned.

Compensated absences	7,425
Retirement incentives	22,500
Change in Net Assets of Governmental Activities (District Wide)	<u>\$ (191,417)</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2006

Agency Funds

Assets

Cash, student organizations	\$ 44,089
Total Assets	<u>\$ 44,089</u>

Liabilities

Due to student organizations	\$ 44,089
Total Liabilities	<u>\$ 44,089</u>

The accompanying notes are an integral part of these financial statements.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1--Summary of Significant Accounting Policies

The Arenac Eastern School District (the "School District") operates under an elected Board of Education and provides educational services to approximately 385 students.

A. Reporting Entity

The accompanying financial statements have been prepared in accordance with criteria established by the GASB for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational and financial relationships that determine which of the governmental organizations are a part of the School District's reporting entity, and which organizations are legally separate component units of the School District. Based on the application of the criteria, the School District does not contain any component units.

B. District-Wide Statements

The District-Wide financial statements (i.e., the Statement of Net Assets and the Statement of Changes in Net Assets) report information on all of the activities of the primary government. The purpose of these statements is to distinguish between activities that are governmental and those that are considered business-type activities. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. All the District's government wide activities are considered to be governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenue includes (1) charges to students or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function, and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes, intergovernmental payments, and other items not included as program revenues are reported instead as general revenue.

The District-Wide statements are reported using the economic resources measurement focus and the accrual basis of accounting. The District-Wide approach is focused more on the sustainability of the School District as an entity and the change in the District's net assets from the current year's activities.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1--Summary of Significant Accounting Policies (continued)

C. Fund Financial Statements

The accounts of the School District are organized on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

The following fund types are used by the School District:

Governmental Funds

The governmental fund statements are prepared using the current resources measurement focus and the modified accrual basis of accounting. The fund approach is focused on the currently available resources and changes in the currently available resources of the District.

General Fund is the general operating fund of the School District. It is used to account for all financial resources except those that are required to be accounted for in another fund.

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. The Food Service and Athletic funds are special revenue funds.

Debt Service Funds are used to account for the accumulation of funds for the periodic payment of principal and interest on general long-term debt.

Capital Project Funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Fiduciary Funds

Fiduciary funds are used to report assets held in a trustee or agency capacity for others and therefore are not available to support School District programs.

The School District has opted to display information for all funds without regard to the criteria for determination of major funds. The School District's fiduciary funds are presented in the fiduciary fund financial statements. Since by definition these assets are being held for the benefit of a third party and cannot be used for activities or obligations of the government, these funds are not incorporated in the District-Wide statements.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1--Summary of Significant Accounting Policies (continued)

D. Basis of Accounting

Basis of accounting refers to the point at which revenues or expenditures/expenses are recognized in the accounts and reported in the financial statements. Accounting basis relates to the timing of the measurements made regardless of the measurement focus applied.

Full Accrual

The full accrual basis of accounting requires recognition of revenues when earned and expenses when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants, categorical aid, and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Modified Accrual

The modified accrual basis recognizes revenues when they are measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are still recognized when incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and severance pay, are recorded only when payment is due.

E. Financial Statement Amounts

Cash

Cash includes cash on hand and demand deposits.

Receivables

Receivables consist of all revenues earned at year-end but not yet received. In general, outstanding balances between funds are reported as "due to/from other funds".

Inventories

Inventories consist of expendable supplies held for the District's use and are carried at cost using the first-in, first-out method.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1--Summary of Significant Accounting Policies (continued)

E. Financial Statement Amounts (continued)

Prepaid

Prepaid amounts consist of payments for which the District will have a future benefit and will be used up at a date beyond the current year-end.

Capital Assets and Depreciation

Capital assets purchased or acquired are reported at historical cost or estimated historical cost. Contributed assets are reported at fair value as of the date received. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. The School District does not possess infrastructure type assets. Depreciation on all assets is provided on the straight-line method over the following estimated useful lives:

Buildings	50 years
Land improvements	20 years
Buses and other vehicles	8 years
Technology	5 years
Furniture and equipment	10-20 years

Accounts Payable

Accounts payable consist of items from which the District benefited during the current fiscal year but has not yet paid.

Accrued Expenditures

Accrued liabilities consist of amounts due on employee's contracts that are due and payable for the current fiscal year and items related to salaries payable, specifically the District's portion of FICA and Medicare taxes and retirement contributions.

Deferred Revenue

Deferred revenue represents amounts for which the District has received or is due to receive but has not yet earned. Deferred revenue is usually caused by the receipt of certain categorical funds that are not expended by the close of the fiscal year. The revenues are deferred until the proceeds have been fully expensed/expended.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1--Summary of Significant Accounting Policies (continued)

E. Financial Statement Amounts (continued)

Long-Term Liabilities

Bonds payable are the result of long-term obligations issued for the purpose of making capital purchases and improvements or the refinancing of previously issued obligations. Compensated absences represent accumulated unpaid vacation and sick leave as earned by employees. The accumulated benefit is payable to the employee upon termination of employment. The District has concluded that estimating a current portion of compensated absences would be impossible; therefore, no portion is recorded as such. Retirement incentives are amounts due to former employees as negotiated at retirement.

Inter-fund Activity

Inter-fund activity is reported as reimbursements or transfers. Reimbursements are reported as inter-fund receivables and payables and are eliminated upon consolidation. Transfers are eliminated upon consolidation.

NOTE 2--Stewardship, Compliance, and Accountability

The School District is required to adopt an annual budget before the beginning of the fiscal year for the General Fund, Food Service Fund, and the Athletic Fund. The accounting basis of the budgets is the modified accrual method. Following are the procedures used in establishing the budgetary data reflected in the financial statements:

1. The District's Superintendent submits to the Board of Education a proposed budget by June 30 of each year. The budget includes proposed expenditures and the means to finance them.
2. A public hearing is conducted to obtain taxpayer comments.
3. Any revisions that alter functional expenditure lines of any fund must be approved by the Board of Education.
4. Budgeted amounts shown in the supplemental information reflect amendments through June 30.
5. Budgets are adopted on a basis consistent with U.S. generally accepted accounting principles.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 2--Stewardship, Compliance, and Accountability (continued)

The budgetary comparison presents information by fund and function. The legal level of budgetary control adopted by the governing body (i.e., the level at which expenditures may not legally exceed appropriations) is the function level. State law requires the School District to have its budget in place by June 30. Expenditures in excess of amounts budgeted are a violation of Michigan law. State law permits districts to amend their budgets during the year. Budget variances are illustrated in the required supplemental information.

NOTE 3--Deposits and Investments

The School District is authorized, by the State of Michigan, to deposit its funds in banks, savings and loan associations, or credit unions having a principal office in Michigan.

The District is also authorized to invest in the following:

- a. Direct bonds and obligations of the U.S. or agency or instrumentality,
- b. CDs, savings accounts with banks, savings and loan associations, or credit unions which are insured with the applicable federal agency,
- c. Commercial paper – within three highest rate classifications by at least two rating services, maturing not later than 270 days,
- d. U.S. or agency repurchase agreements,
- e. Banker's acceptance of U.S. banks,
- f. Mutual funds – investments which local unit can make directly.

All cash is held by federally insured financial institutions. The FDIC insures up to \$100,000 in demand deposits; however, separately named accounts of a governmental entity in a single financial institution may not necessarily be treated as a separate deposit for the \$100,000 limitation.

A summary of bank cash is as follows:

Cash	Total	Insured	Collateralized	Uninsured
				Uncollateralized
General Fund	\$ 445,249	\$ 100,000	\$ -	\$ 345,249
Food Service	16,707	-	-	16,707
Athletic	15,979	-	-	15,979
Debt Service	71,266	-	-	71,266
Capital Projects	41,319	-	-	41,319
Agency	43,904	-	-	43,904
Total	<u>\$ 634,424</u>	<u>\$ 100,000</u>	<u>\$ -</u>	<u>\$ 534,424</u>

The investment policy of the District is to maximize the returns on the District's excess cash balances consistent with safety of those monies and with the desired liquidity of the investments.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 4--Capital Assets and Accumulated Depreciation

Capital asset activity of the School District was as follows:

	Balance July 1, 2005	Additions	Disposals	Balance June 30, 2006
Capital assets not subject to depreciation				
Construction in progress	\$ 1,552,368	\$ -	\$1,552,368	\$ -
Subtotal	1,552,368	-	1,552,368	-
Capital assets subject to depreciation				
Land Improvements	103,400	-	-	103,400
Buildings	2,961,167	1,666,208	-	4,627,375
Buses	434,203	-	129,007	305,196
Technology	404,039	-	-	404,039
Furniture and equipment	678,495	-	-	678,495
Subtotal	4,581,304	1,666,208	129,007	6,118,505
Total Capital Assets	6,133,672	1,666,208	1,681,375	6,118,505
Accumulated depreciation				
Land Improvements	84,510	4,695	-	89,205
Buildings	1,413,783	83,688	-	1,497,471
Buses	406,225	6,548	129,007	283,766
Technology	299,301	43,921	-	343,222
Furniture and equipment	530,558	32,775	-	563,333
Total Accumulated Depreciation	2,734,377	171,627	129,007	2,776,997
Total Net Capital Assets	\$ 3,399,295	\$ 1,494,581	\$1,552,368	\$ 3,341,508

Depreciation expense was not charged to activity as the District considers its capital assets to impact multiple activities and allocation is not practical.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 5--Inter-fund -- Receivables, Payables, and Transfers

The makeup of inter-fund balances and transfers is as follows:

Outgoing Transfer		Incoming Transfer	
General Fund	\$ 29,254	Athletic	\$ 29,254
Total	<u>\$ 29,254</u>	Total	<u>\$ 29,254</u>

Due From		Due To	
General Fund	\$ 11,819	Athletic	\$ 11,819
General Fund	302	Food Service	302
Total	<u>\$ 12,121</u>	Total	<u>\$ 12,121</u>

The transfer from the General Fund to the Athletic fund was to subsidize the Athletic Program.

NOTE 6--Long-Term Debt

The School District issues bonds, notes, and other contractual commitments to provide for the acquisition and construction of major capital facilities and the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the District. Other long-term debts include compensated absences and retirement incentives.

Long-term debt activity is summarized as follows:

	Balance July 1, 2005	Additions	Retirements	Balance June 30, 2006	Current Portion
Governmental Activities					
Durant Bonds	\$ 25,260	\$ -	\$ 1,914	\$ 23,346	\$ 2,004
Compensated Absences	40,287	-	7,425	32,862	-
Building and Site Bonds	1,730,000	-	30,000	1,700,000	40,000
2004 Refunding Bonds	1,045,000	-	140,000	905,000	140,000
Retirement incentives	114,375	-	22,500	91,875	22,500
Retirement incentives 2006	-	120,000	-	120,000	22,000
Totals	<u>\$ 2,954,922</u>	<u>\$ 120,000</u>	<u>\$ 201,839</u>	<u>\$ 2,873,083</u>	<u>\$ 226,504</u>

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 6--Long-Term Debt (continued)

Annual debt service requirements to maturity for the above governmental bonds are as follows:

For Year(s) Ended June 30,	Compensated Absences	Retirement Incentives	Principal	Interest	Total
2007	\$ 32,862	\$ 44,500	\$ 182,004	\$ 90,794	\$ 272,798
2008	-	46,500	192,100	87,558	279,658
2009	-	46,500	197,200	83,366	280,566
2010	-	46,500	209,447	81,604	291,051
2011	-	25,875	212,415	72,875	285,290
2012-2016	-	2,000	1,000,180	257,637	1,257,817
2017-2019	-	-	635,000	57,400	692,400
Totals	<u>\$ 32,862</u>	<u>\$ 211,875</u>	<u>\$ 2,628,346</u>	<u>\$ 731,234</u>	<u>\$ 3,359,580</u>

Governmental Activities

General obligation bonds consist of the following:

2004 serial bonds due in annual installments of \$125,000 to \$140,000 through May 1, 2013; interest at 1.0% to 3.0%	\$ 905,000
2004 serial bonds due in annual installments of \$30,000 to \$215,000 through May 1, 2019; interest at 2.20% to 4.55%	1,700,000
1998 serial bonds due in annual installments of \$1,743 to \$4,053 through May 15, 2013; interest at 8.0%	23,346
Total Bonded Debt	<u>\$ 2,628,346</u>

For the year ended June 30, 2006, the total interest paid on bonded debt was \$93,226.

NOTE 7--Durant Bonds

During 1998, the District elected to bond so they could receive half of its Durant settlement. This created a liability which will be reduced each year with an annual state appropriation made for debt service on the bonds. The District has pledged its right to receive these future appropriations as a condition of receiving the bond proceeds. The annual State of Michigan appropriation is the only revenue source for making the annual debt service payment on the bonds. If the Michigan legislature fails to appropriate the funds, the District is under no obligation for payment.

ARENAC EASTERN SCHOOL DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

NOTE 8--Risk Management

The School District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omission; injuries to employees; and natural disasters. The District has joined together with other school districts in Michigan to form SET-SEG, a public entity risk pool currently operating as a common risk management and insurance program for member school districts. The district pays an annual premium to SET-SEG for its property and liability insurance coverage. The agreement for formation of SET-SEG provides that SET-SEG will be self-sustaining through member premiums.

NOTE 9--Pension Plan

The School District's defined benefit pension plan provides retirement, survivor and disability benefits to its employees. The District participates in the Michigan Public School Employees Retirement System (MPERS), a cost sharing multiple-employer, statewide plan governed by the State of Michigan. Benefit provisions are established by state statute. The MPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing the MPERS Directors, PO Box 30673, Lansing, Michigan 48909 or by calling (517) 322-6235.

Funding Policy

The School District is required to contribute at an actuarially determined rate; the rate at June 30, 2006 was 16.34% of covered payroll. Employees hired before January 1, 1990 contribute 3.9% of their gross pay. Employees hired January 1, 1990 or later contribute between 3% and 4.3%.

The contribution requirements of plan members are established and may be amended by the State of Michigan. The District's contributions to MPERS for the current year and the preceding two years were \$309,120, \$278,121, and \$264,622, respectively.

NOTE 10--Reserved Fund Balance

The District has reserved the following amounts in fund balance:

	Food Service	Debt Service	Total
Reserved for debt retirement	\$ -	\$ 71,266	\$ 71,266
Reserved for inventories	656	-	656
Total Reservations	<u>\$ 656</u>	<u>\$ 71,266</u>	<u>\$ 71,922</u>

REQUIRED SUPPLEMENTAL INFORMATION

Arenac Eastern School District
Budgetary Comparison
For the Year Ended June 30, 2006

	General Fund			Special Revenue Funds (Food Service and Athletic)			
	Original Budget	Final Budget	Actual	Original Budget	Final Budget	Actual	
Revenue							
Local	\$ 272,665	\$ 279,904	\$ 278,425	\$ 64,200	\$ 60,634	\$ 66,074	
State	2,706,068	2,676,273	2,615,186	9,201	7,052	6,537	
Federal	198,444	264,707	221,109	108,800	98,500	97,027	
Incoming transfers and other	33,253	32,638	56,343	40,825	38,306	29,254	
Total Revenues	3,210,430	3,253,522	3,171,063	223,026	204,492	198,892	
Expenditures							
Instruction							
Basic programs	1,666,046	1,711,796	1,684,803	-	-	-	
Added needs	556,035	501,393	448,934	-	-	-	
Support Services							
Pupil	84,367	84,378	81,985	-	-	-	
Instructional staff	89,439	82,255	83,001	-	-	-	
General administration	203,050	198,579	185,368	-	-	-	
School administration	267,620	263,117	226,178	-	-	-	
Business	51,348	49,323	55,546	-	-	-	
Operation and maintenance	320,986	334,362	319,888	-	-	-	
Pupil transportation services	135,120	123,110	124,661	-	-	-	
Other	9,654	14,254	13,275	-	-	-	
Food service	-	-	-	163,747	152,344	144,734	
Athletic activities	-	-	-	64,325	58,806	55,591	
Outgoing transfers	40,825	38,306	29,254	-	-	-	
Total Expenditures	3,424,490	3,400,873	3,252,893	228,072	211,150	200,325	
Excess (Deficiency) of Revenues Over Expenditures	(214,060)	(147,351)	(81,830)	(5,046)	(6,658)	(1,433)	
Fund Balance - Beginning of Year	656,874	656,874	656,874	17,755	17,755	17,755	
Fund Balance - End of Year	\$ 442,814	\$ 509,523	\$ 575,044	\$ 12,709	\$ 11,097	\$ 16,322	

ADDITIONAL SUPPLEMENTAL INFORMATION

Arenac Eastern School District
Schedules of Outstanding Bonded Indebtedness
June 30, 2006

2004 Issue \$1,185,000				
Interest Rate: 1.0 to 3.0%				
Year Ending June 30,	Annual Principal May 1	Semiannual Interest Payment		Total Fiscal Year Requirement
		November 1	May 1	
2007	\$ 140,000	\$ 10,555	\$ 10,555	\$ 161,110
2008	135,000	9,505	9,505	154,010
2009	130,000	8,256	8,256	146,512
2010	130,000	6,859	6,859	143,718
2011	125,000	5,332	5,331	135,663
2012	125,000	3,675	3,675	132,350
2013	120,000	1,800	1,800	123,600
Totals	<u>\$ 905,000</u>	<u>\$ 45,982</u>	<u>\$ 45,981</u>	<u>\$ 996,963</u>

2004 Issue \$1,730,000				
Interest Rate: 2.20 to 4.55%				
Year Ending June 30,	Annual Principal May 1	Semiannual Interest Payment		Total Fiscal Year Requirement
		November 1	May 1	
2007	\$ 40,000	\$ 34,456	\$ 34,456	\$ 108,912
2008	55,000	33,936	33,936	122,872
2009	65,000	33,139	33,139	131,278
2010	70,000	32,115	32,115	134,230
2011	85,000	30,925	30,925	146,850
2012	90,000	29,395	29,395	148,790
2013	105,000	27,708	27,708	160,416
2014	175,000	25,660	25,660	226,320
2015	185,000	22,116	22,116	229,232
2016	195,000	18,278	18,278	231,556
2017	205,000	14,134	14,134	233,268
2018	215,000	9,675	9,675	234,350
2019	215,000	4,891	4,891	224,782
Totals	<u>\$ 1,700,000</u>	<u>\$ 316,428</u>	<u>\$ 316,428</u>	<u>\$ 2,332,856</u>

Arenac Eastern School District
Schedules of Outstanding Bonded Indebtedness
June 30, 2006

1998 Issue (Durant) \$39,539

Interest Rate: 8.0%

Year Ending June 30,	Annual Principal	Semiannual Interest Payment		Total Fiscal Year Requirement
	May 15	November 15	May 15	
2007	\$ 2,004	\$ -	\$ 772	\$ 2,776
2008	2,100	-	676	2,776
2009	2,200	-	576	2,776
2010	9,447	-	3,656	13,103
2011	2,415	-	362	2,777
2012	2,530	-	247	2,777
2013	2,650	-	126	2,776
Totals	<u>\$ 23,346</u>	<u>\$ -</u>	<u>\$ 6,415</u>	<u>\$ 29,761</u>
Total Bond Indebtness	<u>\$ 2,628,346</u>	<u>\$ 362,410</u>	<u>\$ 368,824</u>	<u>\$ 3,359,580</u>

Arenac Eastern School District
Agency Funds
Schedule of Activity and Amount Due to Student Groups
For the Year Ended June 30, 2006

Activity Accounts	Cash Balance July 1, 2005	Cash Receipts	Cash Disbursements	Cash Balance June 30, 2006
Annual	\$ 8,330	\$ 7,537	\$ 9,698	\$ 6,169
Athletics	(258)	523	2,730	(2,465)
Band	848	-	848	-
Baseball	35	1,883	1,766	152
Board of Education	717	346	1,064	(1)
Boy's Basketball	178	-	-	178
Business Club	40	-	40	-
Cheerleaders	665	1,603	1,427	841
Class of 2004	662	-	-	662
Class of 2005	226	-	-	226
Class of 2006	2,227	3,217	4,709	735
Class of 2007	1,589	4,084	2,889	2,784
Class of 2008	1,209	1,839	859	2,189
Community Support	59	-	59	-
Dance Club	136	-	-	136
Elementary Fundraising	-	13,571	4,809	8,762
Elementary Popcorn	672	-	672	-
Fifth Grade Paper	53	-	53	-
Football	334	3,455	4,045	(256)
Girl's Basketball	716	3,615	4,358	(27)
Jewelry	7,327	-	7,327	-
Juice Machine	9,679	1,479	2,000	9,158
Library	836	-	836	-
National Honor Society	325	200	400	125
Petty Cash	(152)	1,228	2,159	(1,083)
Pizza Scholarship	-	148	30	118
Playground Equipment	1,585	-	1,585	-
Scholarship	8,825	2,099	1,978	8,946
Shop	85	40	85	40
Softball	224	1,973	1,911	286
Spanish Club	215	3,197	3,357	55
Speech/Drama	670	577	1,560	(313)
Student Assistance/Teen Institute	326	1,003	772	557
Student Council	5,521	3,272	2,678	6,115
Totals	<u>\$ 53,904</u>	<u>\$ 56,889</u>	<u>\$ 66,704</u>	<u>\$ 44,089</u>



Gardner | Provenzano Schauman & Thomas

CERTIFIED PUBLIC ACCOUNTANTS

Frederick C. Gardner
Giacamo Provenzano
James R. Schauman
Heather A. Thomas

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

August 23, 2006

To the Board of Education
Arenac Eastern School District
Twining, Michigan

We have audited the financial statements of the governmental activities of Arenac Eastern School District as of and for the year ended June 30, 2006, which collectively comprise Arenac Eastern School District's basic financial statements and have issued our report thereon dated August 23, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Arenac Eastern School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses. However, we did issue a letter to management dated August 23, 2006 relating other matters of internal control.

To the Board of Education
Arenac Eastern School District
Page Two

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Arenac Eastern School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management and the Board of Education and is not intended and should not be used by anyone other than these specified parties.

Gardner, Beneniano, Schauman & Thomas, P.C.
Certified Public Accountants



**Gardner | Provenzano
Schauman & Thomas**

CERTIFIED PUBLIC ACCOUNTANTS

Frederick C. Gardner
Giacamo Provenzano
James R. Schauman
Heather A. Thomas

August 23, 2006

Board of Education
Arenac Eastern School District
Twining, Michigan 48703

In planning and performing our audit of the financial statements of the school district for the year ended June 30, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

However, during our audit, we became aware of matters that are opportunities for strengthening internal controls and operating efficiency.

Agency Cash

We noted the school district uses the Agency Fund cash account for General Fund expenditures. Agency funds are custodial in nature and are not available for General Fund expenditures. In addition, we believe that this practice circumvents internal control procedures that have been established by the Board of Education. Although we did find the General Fund had reimbursed the Agency Fund for expenditures made, we do not recommend this practice. We recommend the Board of Education discontinue its use of Agency funds for General Fund Expenditures.

Board Minutes

Board minutes are an important part of the District's permanent records. We noted that Board minutes were not being stored in a common board book. We believe there is a risk that board minutes could be lost and part of the history of the District would not be recorded.

We recommend the District establish a common board book that should be kept in a secure, fireproof place. All minutes from all meetings should be stored in this common board book.

Board of Directors
August 23, 2006
Page Two

During our review of the minutes of the meetings of the Board of Education we noted the presiding officer had not signed all board minutes. To ensure minutes are authentic, we recommend the minutes be signed at the subsequent Board meeting as an indication of approval. Once signed, the minutes should be filed in the common board book.

We will review the status of this issue during our next audit engagement.

This report is intended solely for the information and use of the school district, management, and others within the organization.

Gardner, Revengano, Schaumann & Thomas, P.C.

Certified Public Accountants